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February 3, 1994

By Hand

Mr. William F. Caton
Secretary
Federal Communications Commission
1919 M Street, N.W. - Room 222
Washington, D.C. 20554

NOTICE OF
EX PARTE PRESENTATION

Re: In the Matter of Rate Regulation for Cable Television; MM Docket 92-266

Dear Mr. Caton:

On behalf of *Videomaker Magazine, Inc.* (*Videomaker*), enclosed please find an original and three (3) copies of a report entitled "Leased Access on Cable Television: Recommendations for Change." Following the Commission's release of the Report and Order in this proceeding on May 3, 1993, *Videomaker* has conducted extensive market research on commercial leased access. The results of that research, and *Videomaker's* corresponding recommendations for change in the Commission's leased access rules, are provided in the enclosed report.

In adopting the Report and Order, the Commission acknowledged that its leased access rules were merely "a starting point that will need refinement." (Report and Order, at ¶ 491.) The Commission realized that there had been little activity in the leased access market at that point, and viewed its rules as an "initial guide" until there has been more experience in the leased access market (Report and Order, at ¶ 515.)

Videomaker has responded to the Commission's call. For the past eight (8) months, *Videomaker* has tested the leased access market under the Commission's new rules and has gained significant real-world experience in the leased access market. Through its research, *Videomaker* has discovered various impediments in the market that serve to discourage the development of a genuine outlet

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for the "widest possible diversity" of programming sources, such as the leased access rules are intended to create. Thus, the enclosed report recommends certain refinements to the Commission's leased access rules to help encourage the development of a robust market for competitive and diverse cable programming.

Sincerely,

David B. Jeppsen
Counsel for
Videomaker Magazine, Inc.

Enclosure

cc: Bruce A. Romano
Karen A. Kosar

DBJ/hlh

LEASED ACCESS ON CABLE TELEVISION: RECOMMENDATIONS FOR CHANGE

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LEASED ACCESS ON CABLE TELEVISION: RECOMMENDATIONS FOR CHANGE

Our firm, Videomaker, Inc. has conducted an extensive research project on the regulations and uses of leased access channels on cable TV. We here submit the results of our research with recommendations for further revision of the current leased access provisions (section 612) of the 1992 Cable Act.

Our own experience includes the use of a leased access channel for a program we produce, the publication of a newsletter, The Cable Leased Access Report and correspondence with users of these channels as well as with cable operators around the country. We are also researching and developing a possible Leased Access Network.

Though we are filing at the end of your reconsideration period, we feel the results of our study could prove helpful in your decisions about the leased access provisions. Our recommendations appear in boldface headings.

Lower Rates for "Other" Types of Programming

As we have stated, along with other programmers in an earlier filing, the regulations still allow operators to set rates too high for programs designated "other" in section 612. The current formulas make it impossible for non-affiliated programmers to compete successfully.

We have found only a few full-time channel lessees. They are listed in Appendix One. That there are so few participants in this category, and that most of them were in operation prior to the implementation of the 1992 Cable Act's new rates indicate that the rates are far too high to draw the interests of savvy business people. In sharp contrast, there has been great response to new federal policies that create truly attractive opportunities (cellular phone licenses, MMDS licenses, LPTV licenses, telephone 900 service, etc.).

All of the parties that are leasing channel capacity are doing so at rates far below the implicit maximum rates as set forth by the Commission. Most of these lessees have filed comments with the Commission objecting to the implicit rate calculation contained in the 1992 Cable TV Act.

We have developed several fantail models to study the feasibility of this rate structure. They illustrate the fact that no-one will ever cover his costs with the current rate structure, much less turn a profit. See Appendix Two for the models.
We propose a new, rate-reducing, formula. Rather than setting the ceiling with the highest programmer per category, the FCC should consider setting it with the average implicit value per category. This rate calculation methodology has a better chance of fostering the new programmers Congress sought to encourage. Congress has recognized that an entire category of programmers

(not affiliated with the cable companies) has been discriminated against since the inception of cable TV. How can programmers in this weak, underdeveloped category be expected to compete with the highest income-producing programmers on cable TV? This is exactly what the highest implicit rate calculation allows Some would even argue that the ceiling should be set with the production of the lowest implicit value in the category to give new producers the greatest competitive opportunity.

Using the average implicit rate would allow lessees to share in the savings associated with a multiplication of channels. Digital compression will render far greater channel capacity to each cable operator in the near future. Clearly the average revenue per cable channel received by the cable operators will decrease as the number of channels increases. The highest implicit rate methodology effectively insulates lessees from the cost-per-channel savings made possible by digital compression.

We encourage the Commission to consult Stanley M. Besen or Leland L. Johnson, the originators of the implicit rate concept, to gain from their wisdom on the topic of averaging, especially at the dawn of channel compression.

Here's a good example. We have not been able to identify any successful lessees in the paid category (those proposing to charge subscribers directly to view their programming on a per-event basis). The current formula sets the maximum rate for this type of show at the maximum rate provided by an active program provider. The operator could charge all comers in the category $40 an hour if that's what he realizes from cablecasting a pay-per-view boxing event.

Using our proposed formula, the cable operator would average the net income for an entire month of programming in this category (HBO, Boxing, Disney Channel, ESPN, Howard Stern's New Year's Eve, etc.). He would then calculate the highest implicit rates based upon those results. This is the average implicit rate method.

As an alternative, the Commission should consider abandoning the implicit rate structure in its entirety, and move toward a standard benchmark fromula based on industry averages. As explained in more detail in Appendex 2, industry averages dictate that a for a half-hour program a lessee cannot generate revenue in excess of $.24 per 1000 cable subscribers. Thus, using a benchmark formula, the Commission should prohibit a cable operator from charging leased access rates more that $.24 per 1000 subscribers per half hour, since any rate in excess of that bencmark would likely exceed a lessee's prospective revenues.

Maintain Rates for Direct Sales Programs

As you know some proponents in the direct sales category are lobbying for a maximum rate calculation methodology that would give very favorable rates (below market value) to those programmers selling goods on TV. The direct sales category, however, is not one that needs regulatory intervention in order to stimulate it. This category encompasses infomercials, which have grown to a $900-million dollar a year industry. The infomercial market is so competitive that the price of its access (remnant air time) has risen steadily for years. Large Fortune 500 corporations are now getting into the act. They have driven costs up even more quickly.

If the leased access regulations allow direct sales programs to lease time less expensively than they can get remnant time, the time brokers in this highly developed industry will certainly buy up much, if not all, of the capacity set-aside for leased access. The result? These single-sponsor programs will tend to deliver less genuine diversity compared with the other categories. The Commission is currently engaged in examining the over-commercialism of TV. Lax regulations here will lead to more commercialization.

Regulate Billing and Collection Rates

Transaction processing is another trouble spot for both direct sales programs and pay-per-view programs. The 1992 Cable Act requires the cable operators to provide this service, but the rates that they charge for these services are unregulated. Given the historical resistance the cable industry has displayed toward leased access, it is unlikely that operators will set reasonable rates. They would rather prevent entrepreneurs from charging their viewers for programs.

The Commission should also clarify its position on enabling third party billing and collection companies to provide this service to lessees. Section 612 paragraph 504 requires cable operators to supply access to data to third party billing and collection providers. These companies will likely need access to the newly deployed digital set top boxes as well. They may need to run billing software that would reside in the random access memory of digital converters.

Regulate Mitigation Strategies

Vice President Al Gore has presented the administration's platform on the National Information Infrastructure. He called for non-discriminatory access to cable channels. See Appendix Three for an excerpt from this speech.

The House Report on the 1984 Cable Act cited concerns in the terms and conditions of leases. The legislation reported by the Committee "can act as a safety valve for programmers who may be subject to a cable operator's market power and who may be denied access or be given access on unfavorable terms." (Senate Report No. 102-92 page 30)

Larry Irving, Assistant Secretary for Communications and Information echoed this call for access in recent testimony to the House of Representatives. See Appendix Four for a quote. Nevertheless, the cable companies continue to resist. Recently the same Larry Irving attended the Western Cable Show. Here he joined a round-table discussion with cable operators. The leader of the group encouraged participants to develop "mitigation strategies" to subvert lessees. The strategies he recommended, and some we have discovered through our own research follow.

Regulate Prorating

Some cable operators are inflating the rates for part time (or single program lessees) above the "highest implicit rate" set by the Commission during prime time hours. Their claim is that Section 612 paragraph 518 allows them to prorate the rates for shorter periods in any fashion they please. I recommend, instead, that you require cable operators to prorate short periods by strict division of the monthly rate (i.e. divide the monthly rate by 30 days and then 24 hours to get a standard hourly rate for any time of day including prime time).

Require Open Channels and Choice of Time

Some cable operators are claiming that they have no leased access capacity available, even though they have set aside nowhere near the 10% or 15% of their capacity required by Section 612.

Claiming a lack of capacity, some uncooperative cable operators are offering time slots during very undesirable hours, the very-late-night "graveyard." Many will not air programs at the times necessary for the lessees to reach their target audiences.

If the set-aside channels are truly set-aside, then the cable operator must retain "open" channels or clear some which it already using to make way for lessees.

The Commission should determine whether the operator's own use of these channels, (while no lessee's are using them), is a privilege or a right. If operators are to lease delivery capacity, like a telephone companies would, then I would suggest that those channels belong to the market, not to the cable operator.

Some cable operators are probably claiming that they may be forced to drop some cable networks. It is doubtful that any subscribers would drop their service because of the shuffling of a few cable networks, thereby causing an adverse effect on the operation, financial condition or market condition of any cable system. Although some cable networks may refuse systems that carry them on a part time basis (to make room for part time lessees), there are dozens of new cable networks that have more flexible terms. In fact, it is more likely that the number of channels available on the basic tier will grow because most new cable networks are not charging a licensing fee to the cable operators. As a result adding new networks to basic service has become very inexpensive to the operators.

Guarantee Part-Time Access

Another mitigation strategy discussed at The Western Cable Show is that cable operators could create a minimum lease period. They could, for example, refuse to lease less than one full month, 24 hours a day. Clearly, this discriminates against lessees seeking to distribute anything less than 720 hours (30 days times 24 hours) of programming.

The demand for leased access cable time by part time lessees is far greater than the demand for full time channels and cable operators know this. Truest diversity--a goal of the Cable Act--comes in smaller increments. Witness the boom of independent content providers in the 900-number telephone industry. The independent companies have developed niches far narrower than any small group of big companies could.

Part-time leasing must be preserved if there is to be true access to all comers. This concept has been part of the thinking about access at least since 1970. That is when the Sloan Foundation prepared a report favoring a common carrier system for cable TV. In 1973 a Cabinet Committee on Cable Communications reached a substantially similar solution in the Whitehead Report. It looked forward to a system in which "cable would function much like the Postal Service or more appropriately like the United Parcel Service or a trucking company that for a fee will take programming submitted by anyone and distribute it...to the people who wish to have it." Both these reports speak of systems that serve individuals seeking to transport single "packages"--in this case packages of information.

Cable operators are resistant to part-time leases for many reasons, one of which is the administrative burden of consummating possibly hundreds of leases and transactions per month. This is no reason for the Commission to create policy that discriminates. If these regulations are crafted properly "the market" (entrepreneurs looking for profits) will address the concerns for this administration of part time leases. The administrative burden will give rise a new industry , including access service bureaus. This happened with the 900-number telephone industry, and it could happen with cable television. If a whole channel is the smallest lease-able increment, the provisions favor networks over individual producers. This would be no invitation to "all comers." The situation recalls the railroad industry in the late 1800s. The government set regulations to keep the railroad industry open to "all comers". As common carriers the railroad companies could not discriminate. If you wanted to ship cargo aboard the train, all you needed was the fare--the railroad had to sell you the space in a railroad car (for your cargo). You did not have to rent the whole train. The leased access provisions are written so vaguely as to allow cable operators to insist that lessees must rent the whole train. Independent producers need access to half-hour and hour segments of channel time--not whole channels.

Conclusion

Section 18 of the House amendment amends section 612(c) of the Communications Act. This required the Commission to establish by regulation 1) a formula to determine maximum rates; 2) standards concerning the terms and conditions; 3) standards concerning methods for collection and billing. We feel that the Commission's formula has generated rates that are too high to attract profit seekers. The standards concerning the terms and conditions overlook unique concerns of part time (single program) lessees. Some cable operators are prorating, willy-nilly, for prime time based upon a their own customized methodology that is subverting the intent of Congress to create a "genuine outlet," while others are using the Commission's standard. The standards for collection and billing are non-existent; consequently there are very few, if any, lessees charging subscribers directly for their programming.

Since leased access has been a failure since its inception eight years ago (either because cable operators have managed to stymie it or a market hasn't developed) then why create rulings that may hamper the development of this "genuine outlet"? Distribution of single programs should become the norm and the Commission should develop policies that foster this. As the National Information Infrastructure develops, the concept of a 24 hour per day "channel" will become antiquated and obsolete. The 1992 Cable Act was a hard pill for the cable industry to swallow. It lost on many issues where strong opposition from competitive industries prevailed. Re-transmission consent was feared by many cable operators and MSOs, (though it has had little real impact upon their industry. Must Carry had an adverse impact upon diversity and didn't please the broadcasters either.

In the case of leased access, there was no competing industry because the cable industry has managed to suppress the emergence of independents into the marketplace. Very few comments were filed on behalf of lessees. This lack of opposition enabled cable industry lobbyists to get the Commission to create an inhibiting maximum rate formula. This has left the leased access industry still-born.

Now that all the predicted hardships that were to fall upon the cable industry haven't materialized, it's time to take a long hard look at creating regulations that will work for leased access. The cable industry is and will continue to be very strong, even if the Commission was to create much more favorable terms and conditions for those seeking leases.

As you draft new policies, please bear in mind that there is a new age of individualism in the making. It could bring with it an unprecedented expansion of culture. The cultural limitations of television, tolerable when there was no alternative, are unendurable in the face of new technologies that multiply delivery capacity. Many hope your policies will be crafted in concert with new technologies in order to alter the balance of power between the distributors and the creators. This could break the bottleneck of which Vice President Gore spoke.

Since its beginning TV has been a medium of mass-produced and mass-consumed commodities full of mediocre content. Congress declared the laudable objective to change this and "assure the widest possible diversity of information sources are made available to the public." With proper regulation of the cable TV industry, I'm sure you will achieve this landmark change in telecommunications.

APPENDIX ONE

Current Leased Access Users

CHRM	Howard Austin	Huntsville, AL
Paradise TV	Jim Kartes	Maui, HI
FBTV	Bev Carter	Sugarland, TX
Sur Corp	Luis Guerra	Miami, FL
Valuevision	Mark Payne	Eden Prairie, MN

APPENDIX TWO

Models showing how the current rate structure for leased access channels prohibits new programmers.

Using the Commission's example for the "other category" the leasing fee for a typical system would be 50 cents per subscriber per channel per month. " To wit: an operator pays nothing for the programming on his basic tier. Assuming there are 20 channels on the basic tier, and the monthly rate for basic tier service is $20.00, then the implicit subscriber fee to view this channel is $.50. Because all its subscribers subscribe to the basic tier, the implicit monthly fee per subscriber for access to this channel is:

[($0.50 - $0.00) X 1.00] = $0.50

If a national full-time cable network was to succeed in a leased access venture it would attempt to obtain carriage in all 63 million (63,000,000) cable households. The yearly leasing costs for this network would be three hundred and seventy eight million dollars ($378,000,000.00).

[($0.50 X 63,000,000) X 12 months] = $378,000,000.00

The economics of generating a profit in cable TV program distribution are totally incompatible with the hypothetical concept of paying several hundred million dollars to lease delivery capacity.

In another financial model we look at the economics of one half-hour program. To obtain carriage for one half hour program to all 63 million cable households (63,000,000) subscribers, the leasing fee would be $21,875.00.

[($0.50 X 63,000,000) / 30 days/ 24 hours/ 2] = $21,875.00

The revenue for any programming in this category must come from advertisers. According to The Economics of Basic Cable Networks 1993 by Paul Kagen Associates the rates for TV advertising averages around $4.00 per thousand viewers. There are twelve (12) commercials in each program. The percentage of the subscribers that tune in to the show (the rating) is the key factor in determining the advertising revenue. The average rating for a cable TV program is half a percent (0.5%) according to the same source. Many established cable networks never obtain ratings of 0.5%. The Family Channel averages 0.4%, the Black Entertainment Network averages 0.3%. It would be very hard for a program on a leased access channel to obtain a rating of 0.5%. However in this model we assume the program obtained a .5% rating. The ad revenue would be:

[(63,000,000 X 0.5%) / 1000] X $4 X 12 = $15,120

If we subtract the cost of leasing from the ad revenue, we find that the producer would lose $6755 per airing--and that assumes he has no production costs. The real production costs for a half-hour cable TV program average around $6,600, according to the Cable TV Programming Newsletter from Paul Kagen Associates No. 166 February 21,1992, page 2.

This formula also assumes that the leased time is prorated for the half-hour by strict division of the monthly rate. In practice, some operators prorate prime-time hours as high as five times the average implicit fee. At those rates, the producer of a natinal program would stand to lose up to $33,775 per airing.

In our final financial model we look at the economics of one half-hour program cablecast to only 1 million households. The leasing fee would be $347.00:

[($0.50 X 1,000,000) / 30 days/ 24 hours/ 2] = $347.00

The revenue for any programming in this category must come from advertisers. The rates for TV advertising average around $4.00 per thousand viewers. There are twelve (12) commercials in each program. In this model we also assume the program obtained a .5% rating. The ad revenue would be:

[(1,000,000 X 0.5%) / 1000] X $4 X 12 = $240.00

Again subtracting costs from revenues, we find our producer losing $107 per airing, without production costs. The industry averages discussed above indicate that a lessee cannot, on average, produce revenue in excess of $.24 per 1000 subscribers per half hour.

APPENDIX THREE

Excerpt from Vice President Gore's Speech Calling for Non-Discriminatory Access to Cable Channels

"We cannot permit the creation of information bottlenecks that adversely affect information providers who use the highways as a means of supplying their customers.

"Nor can we can permit bottlenecks for information consumers who desire programming that may not be available through the wires that enter their homes or offices.

"Preserving the free flow of information requires open access, our third basic principle. How can you sell your ideas, your information, your programs, if an intermediary who is also your competitor has the means to unfairly block your access to customers? We can't subject the free flow of content to artificial constraints at the hands of either government regulators or would-be monopolists.

"We must also guard against unreasonable technical obstacles. We know how to do this; we've seen this problem in our past. For example, when railroad tracks were different sizes, a passenger could not travel easily from a town served by one railroad to a town served by another. But the use of standardized tracks permitted the creation of a national system of rail transport. Our legislative package will grant the Federal Communications Commission the future authority, under appropriate conditions, to impose non-discriminatory access requirements on cable companies. In the information marketplace of the future, we will obtain our goals of investment, competition and open access only if regulation matches the marketplace.

"...they would provide their services and access to their facilities to others on a nondiscriminatory basis. The nation would thus be assured that these companies would provide open access to information providers and consumers and the benefits of competition, including lower prices and higher-quality services, to their customers."

APPENDIX FOUR

Testimony of Larry Irving, Assistant Secretary for Communications and Information, U.S. Department of Commerce, on Telecommunications Reform Legislation. Presented before the Subcommittee on Telecommunications and Finance Committee on Energy and Commerce of the House of Representatives. Presented January 27, 1994.

"The public benefits of the information revolution would be severely diminished without a wide range of diverse programming. An advanced information infrastructure, to be truly useful, must offer a potpourri of educational material, health information, home and business services, entertainment, and other programming matter, both passive and interactive. Barriers to open access and widespread availability of programming serve only to harm users."